Services-led Growth and Industrial Policy: Lessons for Pakistan

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Abstract

The emphasis on industry-led economic growth and development policy under both mercantilist and export-oriented approach has earned little success in developing countries like Pakistan. This is due to the lack of R&D base and capital. The approach is highly intensive in both of these factors. Services sector today contributes more than 50 percent and 44 percent towards Pakistan's GDP and employment, respectively. The inter-sectoral linkages of services with industry imply strong existing and potential spillover effects for value added activities in these sectors. This paper through an extensive review of literature and empirical evidences from Pakistan examines the potential of services-led industrial, trade and growth policy for Pakistan. This may help Pakistan to achieve objectives of value addition and diversification of production, competitiveness, employment, poverty alleviation, sustainable economic growth and development, and stability of external accounts.

Key Words: Economic growth, industrial policy, Services Sector

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1 Introduction:

The recent structural shift of global economy from manufacturing to services sector, coupled with the pressure on economies to liberalize their services trade under General Agreement on Trade in Services (GATS), has brought the theorist and policy makers in services-dominated economies to devise appropriate theoretical and policy responses to align their services-dominated economies with their industry, trade, and economic growth and development objectives. The issue is more distinct for such services-dominated countries in developing countries group. The emphasis on industry-led economic growth and development policy under both mercantilist and export-oriented approach has earned little success in developing countries like Pakistan due to the lack of R&D base and capital. However, the approach is highly intensive in both of these factors. This approach has also failed to significantly contribute towards employment, value-added exports and its growth rate, and poverty alleviation. Services today contribute more than 50 percent towards Pakistan's GDP and 44 percent towards employment.

The inter-sectoral linkages of services with agriculture and industry imply strong existing and potential spillover effects for value added activities in these sectors. The lack of appropriate policy for the competitiveness and growth of this huge sector also poses serious threats to economic growth, employment, and external account balances in the wake of GATS-led liberalization.

In this paper, through an extensive literature review and empirical evidences, we have examined the potential of services-led industrial, trade and growth policy in the Pakistan's context. In order to achieve the value addition objectives and diversification in production, competitiveness, employment, poverty alleviation, sustainable economic growth and development, and stability of external accounts a reconsideration of pros and cons of every action of the economy is essential. The study seeks to elaborate the implications of services-led policies in Pakistan for achieving above mentioned macro and micro economic objectives while simultaneously maintaining the policy focus towards manufacturing value added activities. The proposed alignments in the overall economic growth and policies (i.e. development, industrial, and trade etc...) in line with global trends towards services and its structural dynamics have been reviewed.

The paper is composed as follows: section-I gives an introduction of the issue; section-II explains global trends towards services growth: evidences from Pakistan's economy; section-III reviews the Pakistan's economic growth and industrial policies; section IV services-led industrial, trade and growth policy theory in domestic potential capitalisation

context; section-V describes the conclusion followed by limitations and future directions in section-VI.

2 Global Trends Towards Services Growth: Evidences from Pakistan's Economy:

2.1 Services Sector: Distinct Character and Global Trends

The last two decades have witnessed services sector as the largest and fastest growing sector in the global economy. It has provided more than 60 percent of the global output and, in many countries, even larger share of employment (Banga, 2005). Top 50 MNEs ranked by fortune 500 during 2006 were in financial services sector. A dacade ago the manufacturing MNEs were placed at the same place. The declining share of manufacturing paralleled with rising contribution of services in the developed economies of US, UK, EU has transformed them into what is termed as 'post-industrial economies'.

According to World Investment Report 2004, the flows of Foreign Direct Investment (FDI) into services sector are much higher than in manufacturing sector pushing the stock of FDI in services. The significance of services in MNEs activities is also evident by the expression of MNEs as the exporters of knowledge-intensive intangible assets (Markuesen, 2004). The picture for the developing countries varies across the group. ASEAN 4 and China today have manufacturing as the largest portion of the economy, however, the other developing countries in Asia like Singapore, India, Sri Lanka, Bangladesh and Pakistan have more than 50 percent of their output contributed by services sector (Sudha, 2007; Roach, 2004).

Services are distinct from the commodity producing sector in a number of ways: its heterogeneity of output; inseparability of production and consumption; lack of ownership; and intangibility etc. The detailed characteristics and differentiating features of services and their implications for business strategies are frequently discussed in the marketing literature (Shostack, 1987; Berry, 1980; Cowell, 1984; Rathmell, 1966; Kotler, 2005). The economic differences between the two sectors exist in terms of skilled-labor intensity; high knowledge-intensity; and high employment elasticity of economic growth. Another differentiating feature is asset specificity of services, which require the movement of some factors of production during trade activities as against trade in goods. Aiming at employment and economic growth with lack of capital and R&D facilities, which are the key for manufacturing value added; these features of services make this sector suitable for developing economies.

The key to value addition in services is knowledge management, which implies investment in human capital like education, health, training and development. Another issue in services versus goods is differentiation between them. Very few products can be classified as pure goods and very few services are without goods component. In reality services consume a lot of manufactured goods for their successful execution[1]. The Molecular Model (Shostack, 1977) is considered classic in differentiating the services

[1] Like equipments, tools, furnishings etc. and manufacturing goods also accompany a lot of services in their final form to the customers like advertising, warehousing, transportation, retailing etc.

entities from manufacturing ones. Services are classified by WTO under the GATS into 12 areas with 161 sub-sectors according to four modes of service delivery: cross border supply; consumption abroad; commercial presence; and presence of natural persons. The United Nations' International Standard Industrial Classification (ISIC) has defined well elaborated classification for the services as well.

2.2 Services Sector in Pakistan:

The pattern of Pakistan's economic growth and structural transformation is somewhat controversial in the light of the conventional logic of economic development which explains it in sequence from agriculture to manufacturing to services. This sequence is observed by the development evidence of developed countries like USA, EU. These countries after being transformed from primary sectors to manufacturing are now experiencing rise in services sector parallel with the declining share of manufacturing. On the other hand, Pakistan has witnessed the declining share of agriculture from over 50 percent in 1950s to less than a quarter in 2007 being eroded by a buoyant services sector with contribution to the national accounts at around 54 percent in 2006-07. This pattern has been shared by a number of developing economies such as India, Sri lanka, Bangladesh, Singapore, Indonesia and many Latin American and African economies. It is in sharp contrast to the other developing countries in Asia like ASEAN 4 and China, which maintain largest contribution of industrial sectors to their national output and economic growth. These contrasting pictures of countries like Pakistan demand a different approach towards their economic management policies in order to capitalize over their varied economic structure.

India has done quite well in this direction by aligning her growth and industrialization policies with the services sector (Kojima, 2007; Sing, 2006; Banga, 2005; Banga, 2004; Nath, 2007). In Pakistan, the services sector is still unable to get the deserved policy space in economic decision making as there no well planned policy available for this sector. The rapidly changing boundaries between services and industry, and out-dated, ambiguous services classifications is another confusion found in the literature while collecting and analyzing data related to services sector (Burki and Hussain, 2007).

On the theoretical side, with the exception of India, again the industry and agriculture sectors have been the focus of research of various policy research institutions. Researchers in the developing countries, including Pakistan, have only few studies which emphasized the role of services in economic growth, industrialization and competitiveness (Haque, 2006). Indian researchers observing the phenomenon of services growth and its contribution in the economy made it the topic of their research and policy suggestions at very early stages of accelerated growth in 1990s (Kojima, 2007; Sing, 2006; Banga, 2005; Banga, 2004). It is partly because of the output structures of the ASEAN 4 and China that are characterized by huge growth of industrial sector except India, Pakistan, Singapore, Sirilanka where the services sector took the lead in the growth process in 1990s (Venu Menon, 2007).

The services sector, which contributes 53.3 percent to GDP in 2006-07, has recorded the highest growth in the last two decades because of rapid expansion in the financial sector, wholesale and retail trade, and telecom services. Table 1 below identifies the major services sub-sectors with their contribution to the national output over the last seven years in comparison with 1969-70.

Table 1: Sectoral Composition of GDP in Pakistan

(At constant factor cost (In %)

	1969-70	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Commodity Producing Sector	61.6	47.9	47.6	48.4	48.7	47.2	46.7
1. Agriculture	38.9	24.1	24	22.9	22.4	21.3	20.9
- Major crops	23.4	8	8.2	7.8	8.4	7.5	7.6
- Minor Crops	4.2	3.1	3	2.9	2.7	2.6	2.4
- Livestock	10.6	12	11.7	11.2	10.6	10.6	10.4
- Fishing	0.5	0.3	0.3	0.3	0.3	0.3	0.3
- Forestry	0.1	0.7	0.7	0.6	0.4	0.2	0.2
2. Mining &Quarrying	0.5	1. 2.4	2.5	2.6	2.7	2.6	2.6
3. Manufacturing	16	15.9	16.3	17.3	18.3	18.9	19.1
- Large Scale	12.5	10.4	10.6	11.7	12.9	13.4	13.6
- Small Scale	3.5	5.6	5.6	5.6	5.4	5.5	5.6
4. Construction	4.2	2.4	2.4	2	2.1	2.1	2.3
5. Electricity & Gas Distribution	2	3	2.5	3.7	3.2	2.3	1.8
Services sector	**38.4**	**52.1**	**52.3**	**51.5**	**51.4**	**52.8**	**53.3**
6. Transport Storage and	6.3	11.4	11.4	10.9	10.4	10.4	10.3
7. Wholesale and Retail Trade	13.8	17.8	18	18.2	18.7	19.1	19.1
8. Finance and in	1.8	3.5	3.3	3.4	4	5	5.6
9. Ownership of Dwellings	3.4	3.2	3.1	3	2.9	2.8	2.7
10. Public Admn. & Defence	6.4	6.4	6.6	6.3	5.9	6	6
11. Other Services	6.7	9.8	9.9	9.7	9.5	9.5	9.6
12. GDP (Constant Factor Cost)	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Affair's Wing, Finance Division

The role of services sector in growth rate during last decade expresses its existing and potential contribution in the economic growth and development process (Table 2). Services sector continues to be the major driving force in its contribution to economic growth. The commodity producing sectors (i.e. agriculture and industry) has contributed two-fifth and the service sector contributed the remaining three-fifth to the real GDP growth during 2006-07. The CPS contributed 30.2 percent or 2.9 percentage points to this year's growth while the remaining 59.8 percent or 4.2 percentage point's contribution came from services sector.

Table 2: Sectoral Contribution to the GDP Growth

(In % points)

Sector	2002-03	2003-04	2004-05	2005-06	2006-07
Agriculture	1.0	0.6	1.5	0.4	1.1
Industry	1.0	3.8	3.1	1.3	1.8
Manufacturing	1.1	2.3	2.7	1.8	1.6
- Services	2.7	3.1	4.4	4.9	4.2
Real GDP (Fc)	4.7	7.5	9.0	6.6	7.0

Source: Economic Survey of Pakistan 2006-07

2.2.1 Inter-Sectoral Linkages of the Services sector:

The report of the working group on services for Medium Term Development Framework (MTDF 2005-10) developed by the Planning Commission of Pakistan classifies the services sub-sectors into 11 categories. It documents information related to the inter-sectoral linkages between services and other sectors of the economy. The services sector has strong linkages with other major sectors of the economy. It is also strongly embedded in the sale and purchase of primary commodities and manufactured goods as well.

According to MTDF 2005-10, the salient features of inter-sectoral backward and forward linkages in the past couple of years are:

i. Of the non-factors input used by the services sectors, 61.1 percent were purchased from commodity producing sectors, suggesting strong backward linkages of services with commodity producing sectors.

ii. Of the total purchases from the commodity sectors, 73.9 percent were purchased from manufacturing sector, followed by 14.6 percent from construction, and 7.7 percent from electricity and gas sectors. The service sectors purchases from agriculture sector account for 3.3 percent of total purchases from commodity sectors.

iii. The shares of individual service sectors in total purchases by commodity producing sectors are agriculture 28.1 percent, mining and manufacturing 70.2 percent, electricity and gas distribution 1.0 percent, and construction 0.7 percent.

The said report mentions key requisites for an economically vibrant service sector as good infrastructure (ICT, transport, shipping) ability to plan and prepare the complete logistics chain, mobilization of human resources and entrepreneurial capacity, good language and communication skills, and a clear understanding of how these tools can be harnessed. But what the report fails to identify is the understanding of how these tools and competences can achieve and maintain the competitive advantage in services i.e. by linking services with industry and agriculture policies to capitalize over the inter-sectoral linkages.

Table 3: Inter-Sectoral Linkages between Services and Commodity Sectors (Agriculture and Manufacturing)

(In Rs. Million)

Sectors	Sale to Commodity Sectors	Purchases from Commodity Sectors	Balance	Remarks
Wholesale and Retail Trade	162,428	5,791	156,637	Strong forward linkages
Hotels and Restaurants	760	7,061	-6,301	Strong backward linkages
Transport, Storage Communications	51,039	48,107	2,932	Strong forward linkages
Banking and Insurance	6,762	1,545	5,217	Forward Linkages
Real Estate Services	2,345	2,998	-653	Both
Business Services	12,940	1,851	11,086	Strong forward Linkages
Public Admn. And Defence	1,078	54,396	-53,318	Strong backward linkages
Education Services	235	1,668	-1,433	Backward linkages
Healthcare Services	50	2,895	-2,484	Backward linkages
Social and Cultural Services	79	3,616	-3,537	Backward linkages
Personal and Household Services	0	4,190	-4,190	Backward linkages
Total	**237,716**	**134,121**	**103,595**	Forward strong relative to backward linkages

Source: Report of Working Group on Services for MTDF, 2005-10; September 2004

3 Pakistan Economic Growth and Industrial Policy Reviews:

3.1 Structural Transformation in Pakistan (1980-2007): Issues of Competitiveness, Diversification, Employment, Growth, Poverty Alleviation, and Current Account Deficit:

After the failed experience of mercantilist and import substitution industrial policy since 1950s resulting into inefficient industrial sector with low productivity and no international competitiveness, Pakistan, like many other developing economies, shifted the policy focus to a liberal and export-led economic growth and industrialization in late 1980s under structural adjustment program (SAP) envisaged jointly by World Bank and IMF. Over the course of last thirty years, the economy has undergone a number of structural transformations namely export-oriented industrialization, liberalization, privatization, deregulation and market-orientation with an implied emphasis on industrial sector as a catalyst for this transformation. While the same policy produced miraculous results for East Asian economies transforming them into modern and highly competitive economies with high productivity, skill-intensive and technology oriented industrial sector, the outcome for Pakistan was not even satisfactory (Hussain, 2000; Burki, 2006; Dutta and Ahmed, 2006). As per the economic classification in Table 2, the goods exports of Pakistan are structurally transformed into majority manufacturing as the share of manufacturing exports has increased from 44 percent in 1970s to 79 percent in 2006-07.

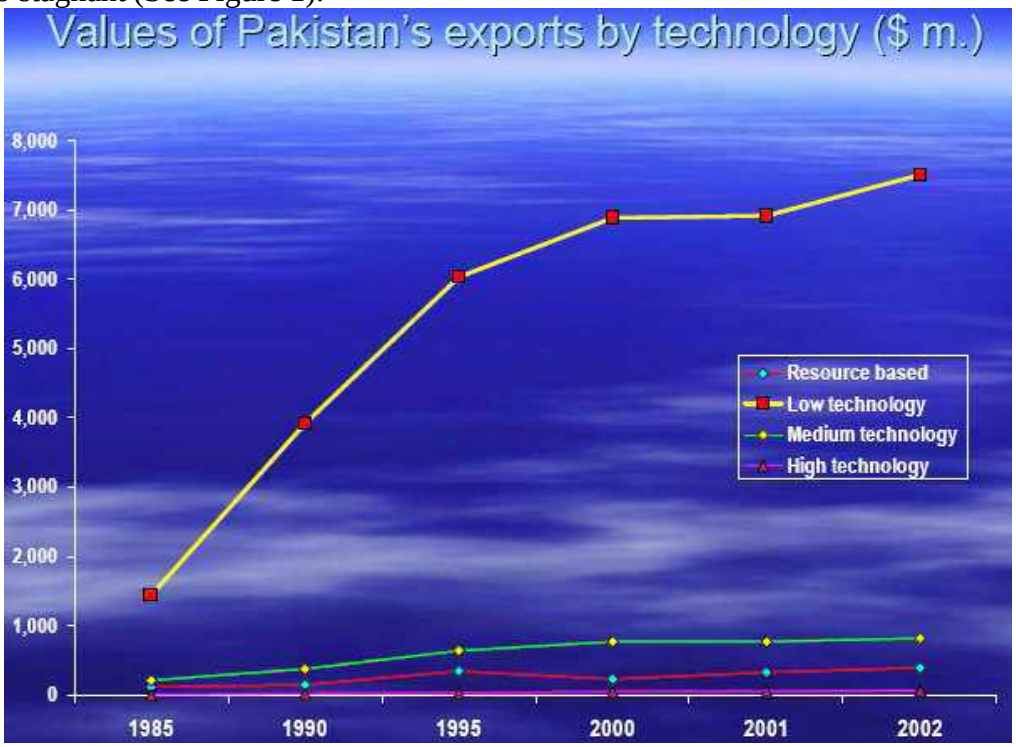
Table 4: Structural Transformation of Manufacturing Exports as per Economic Classification

Year	Primary Commodities		Semi-Manufactures		Manufactures Goods	
	Value	Percentage Share	Value	Percentage Share	Value	Percentage Share
1970-71	850	33	472	24	878	44
1971-72	1,510	45	914	27	847	28
1972-73	3,366	38	2,583	30	2,502	30
1973-74	4,007	30	2,284	23	3,860	38
1974-75	4,933	48	1,308	13	4,047	39
1975-76	4,902	44	2,058	18	4,283	38
1976-77	4,822	41	1,888	17	4,783	42
1977-78	4,633	38	1,912	15	6,435	50
1978-79	6,475	32	3,489	21	7,663	47
1979-80	9,818	42	3,519	15	10,053	43
1980-81	12,624	44	3,320	11	13,138	45
1981-82	9,112	35	3,507	13	13,651	52
1982-83	10,326	30	4,818	13	19,498	57
1983-84	10,789	20	5,172	14	21,378	57
1984-85	10,981	20	6,664	17	20,334	54
1985-86	17,119	35	7,882	15	24,561	49
1986-87	18,788	28	13,214	21	33,245	53
1987-88	22,103	28	15,268	20	41,012	52
1988-89	22,507	33	16,937	19	43,679	48
1989-90	21,511	20	25,157	24	50,661	50
1990-91	25,820	10	33,799	24	78,663	57
1991-92	32,545	18	36,731	21	102,352	60
1992-93	20,133	18	36,537	21	114,383	64
1993-94	21,321	10	49,748	24	195,430	68
1994-95	28,113	11	62,624	25	100,438	64
1995-96	47,652	10	63,832	22	182,087	62
1996-97	30,452	11	66,838	21	225,972	68
1997-98	47,357	13	64,633	17	281,120	70
1998-99	45,143	13	70,288	18	274,911	70
1999-00	53,813	12	68,238	15	321,637	73
2000-01	67,783	13	81,288	15	380,999	72
2001-02	63,346	14	80,438	14	420,163	75
2002-03	71,104	11	71,323	11	500,777	78
2003-04	70,718	10	83,991	12	554,995	78
2004-05	92,018	11	85,433	10	675,586	70
2005-06	112,268	11	100,029	11	700,543	78

Source: Economic Survey of Pakistan (2005-06)

But the picture looks quite dismal if the exports are classified according to the level of technology used, under Asian Development Bank Institute's classification (2004). The study by Lall (2005) under ADBI report (2004) indicates that over the period of structural

transformation, the export growth is concentrated in low-technology goods and the value of medium and high technology exports has been quite low in total exports and its growth is also stagnant (See Figure 1).



Source: Lall, 2005

Figure 1: Structure of Pakistan's exports according to Asian Development Bank Institute's Classification

These facts indicate the failure of the export-led economic growth policies pursued under SAP regime, which took industrial sector as the catalyst of economic growth, development and poverty reduction, due to lack of complementary support policies to develop a competitive and viable industrial structure. The lack of competitiveness, concentration of manufacturing production in few industries and concentration of international markets are other issues faced by industrial sector in the globalize market place (Ali, 2000; ADB Technical Assistance Report, 2008). Out of total 18 billion dollar increase in textile exports by 12 textile exporting countries in the region, China grabbed 14 billion dollar, India 2 billion dollar while remaining two billion dollars were shared among the rest of 10 countries (Pasha, 2006).

The performance of the major export industry, textile and other core categories related to manufacturing has been poor. The trade data for FY07 indicates that textile exports growth declined from last years average of 14.4 percent to only 4.9 percent during FY07, whereas non-textile growth declined from the last four years' average of 19.2 percent to only 0.6 percent in FY07. The concentration of exports into textiles and clothing, which are declining sectors in global trade and investment activities, indicates the vulnerability

of the export earnings (See Table 3). This leads to the conclusion that the existing industrial and trade policy which is not complemented with the composition of services sector and concentrated around the laggard sectors in the global markets is irrelevant to sustain long run economic growth and development; and overcome current account imbalances.

Table 5: Share of Major Exports and their Trend 1996-97 to 2006-07

(Percentage Share)

Commodity	96-97	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07*
Cotton Manufacturers	61.3	59.1	61	58.9	59.4	62.3	62.3	57.4	59.4	61.5
Leather	7.7	6.9	6.3	7.5	6.8	6.2	5.4	5.8	6.9	4.5
Rice	5.6	6.9	6.3	5.7	4.9	5	5.2	6.5	7	6.6
Synthetic Textiles	6.1	5.1	5.3	5.9	4.5	5.1	3.8	2.1	1.2	3
Sports Goods	3.7	3.3	3.3	2.9	3.3	3	2.6	2.1	2.1	1.6
Sub-Total	84.4	81.3	82.2	80.9	78.9	82.6	79.3	73.9	76.6	77.2
Others	15.6	18.7	17.8	19.1	21.1	17.4	20.7	26.1	23.4	22.8
Total	100	100	100	100	100	100	100	100	100	100

*July, March (Provisional)

Source: Ministry of Commerce & Federal Bureau of Statistics

4 Services-led Growth, Trade and Industrial Policy: Theory in Domestic Potential Capitalisation Context

4.1 Services-led Growth: Implications for Employment and Development in Pakistan

The results of industry-led economic growth in terms of employment generation is again disappointing when we consider the policy focus extended to this sector over the period of structural transition (Table 4). The table also indicates the growing importance of services sector in employment generation over the transition period as the share of services in employment has increased from around 23 percent to 28 percent in contrast to declining share of agriculture employment and negligible employment growth in industry. The increase in the share of services in employment is highest relative to the employment growth in other sectors. This indicates the higher employment elasticity of growth and confirms the hypothesis of high labor intensity of services sector implying the socioeconomic potential of this sector for more and better jobs. The stagnancy of employment growth in industry despite impressive industrial growth rates implies a much lower employment elasticity of growth in this sector explaining its inability to bring any socioeconomic change and reduce poverty.

Paci (2007) has quantified the inability of the economic growth rates in South Asia and Sub-Saharan Africa to absorb the growing labor force. The high employment elasticity of services sector around 0.67 % in Pakistan (MTDF, 2004) relative to manufacturing and agriculture is another feature of this sector which makes it attractive for an employment oriented growth strategy. Keeping in view the employment dynamics of services sector, one can expect that a percent economic growth would produce more jobs if the growth is

contributed by services sector and, thereby, can get Pakistan out of the unemployment trap. Such employment friendly growth has strong potential for the improvement in the socio-economic indicators due to its inclusive character.

Table 6: Sectoral Composition and Trend of Employment in Pakistan

(Percentage)

Year	Agriculture	Mining & Manufacturing	Construction	Electricity & Gas Distribution	Transport	Trade	Others
1990	51.15	12.84	6.38	0.59	4.89	11.93	12.22
1991	47.45	12.33	6.82	0.83	5.24	13.24	14.22
1992	48.27	12.53	6.33	0.79	5.51	13.10	13.48
1993	47.55	11.00	6.93	0.84	5.52	13.32	14.84
1994	50.04	10.12	6.50	0.87	4.95	12.78	14.75
1995	46.79	10.50	7.21	0.82	5.07	14.50	15.12
1996	46.79	10.50	7.21	0.82	5.07	14.50	15.12
1997	44.15	11.20	6.75	0.93	5.71	14.62	16.60
1998	47.25	10.15	6.26	0.70	5.48	13.87	16.28
1999	47.25	11.15	6.26	0.70	5.48	13.87	16.28
2000	48.42	11.55	6.26	0.70	5.03	13.50	15.02
2001	48.42	13.81	5.78	0.70	5.03	13.50	15.02
2002	42.09	13.91	5.78	0.81	5.90	14.85	16.39
2003	43.05	13.80	6.05	0.81	5.90	14.85	16.39
2004	43.05	13.80	5.83	0.87	5.73	14.80	16.12
2005	43.05	13.80	5.83	0.67	5.73	14.80	16.12
2006	43.37	13.83	6.13	0.66	5.74	14.87	15.49
2007	43.37	13.83	6.13	0.66	5.74	14.87	15.49

Sources: Federal Bureau of Statistics, Pakistan

The box 1 below further strengthens the hypotheses of services-led growth and industrialization as the sources of employment, economic development and poverty reduction in Pakistan. The leading sub-sectors in job creation in Pakistan are identified by the ministry of labor in Pakistan the most of which belong to the services sector. The poverty reducing role of services sector is well elaborated in the literature and has empirical evidence from Pakistan's experience. While studying the nature of poverty and its prospects in Pakistan, Herani; Waseem; Rajar and Sheikh (2008) have mentioned that the poverty reduced in 1980s and then in 2003 onward by growth in services, construction and public spending on social services sector along with other factors such as provision of micro credit facilities. The high labor intensity of services also supports the hypothesis.

Box 1: Emerging Employment Scenario in Pakistan: Leading sub-sectors in job creation

Many new areas have recently emerged as sources of employment leading to outsourcing of Pakistan' wealth of miss professionals to the rest of the world. The telecom, auto service stations, show rooms, hotels and restaurants, livestock and dairy sectors dominate in jobs creation. The leading industries/sectors include:

Telecom and IT Sector	Mobile phone, wireless loop and LDI companies, public call offices internet service providers, broad band service providers cable services, electronic media companies, information technology and internet related companies and call centers.
Health and Education Sector	Private and philanthropic hospitals and clinics, biomedical sciences and biomedical and genetic engineering private and non governmental educational institutions, and scientific research and development
Allied Agricultures Sectors	Dairy and milk processing packaging and marketing, livestock, fruits and vegetable industry, fisheries and feed mills
Financial Services	Islamic banking services, new private banks including micro financing institution risk managers in the financial sectors, leasing and insurance
Transport Sector	Intercity and intra city coach, bus and transport services, and private airline companies.
Construction	Construction services particularly plumbers, electricians and masons.
Others Services	Advertising, marketing, creative, services, accountancy and management consultancy and electronic and print media.
Chemical	Fertilizer, pesticide, Seeds and agro-chemical distribution
Oil and Gas	Oil and Gas exploration and drilling, petrol and CNG filling stations.

Sources: Ministry of Labour & Manpower

4.2 Challenges of WTO-led Trade Liberalization: A Services-dominated Logic

Under GATS, the Federal Bureau of Standards (FBS) and The State Bank of Pakistan (SBP) are the two focal institutions responsible for collecting most of the data related to GATS. SBP has started compiling Balance of Payments (BOP) statistics from November 2003 onwards on the basis of the Fifth IMF Balance of Payments Manual. But the problems of well defined classification of services and the absence of data related to these hinder the capability of the theorists and policy makers to incorporate appropriate policy response in the trade policy. This has also handicapped the Pakistani officials during GATS negotiations at WTO to develop a viable and effective services liberalization plan to avoid adverse impacts on the domestic economy (Burki and Hussain, 2007).

The lack of institutional foundation and commitment for services sector is evident from the fact that the commerce ministry had not established a specialized wing in the Trade Development Authority of Pakistan (TDAP) until 2005 to provide a platform for identifying potential markets and platforms for the export of services sector. There is still no coherent policy for the services trade of Pakistan and the trade policy is silent about it. The WTO-led trade liberalization has much more to do with the services sector than industry and agriculture sector in Pakistan. While the primary challenge of trade liberalization to industry and agriculture is that of export growth, it is the challenge of output and employment survival to the services. The absence of a competitive services

sector means that 54 percent of domestic income and 40 percent of employment can be eroded by international competition after GATS, which in turn can produce a spiral of socio-economic crisis. Thus the globalization poses more threats to the domestic economy via services sector as against industry or agriculture.

The hypothesis can be confirmed through the analysis of the composition of current account imbalance in Pakistan in recent years. Much of the current account deficit is contributed by services trade component. The analysis of the current accounts deficit depicts services as the largest contributor of this imbalance (Table 5). The poor performance of services export coupled with a surge in the services imports have added to the problems of exchange rate instability, burden of payments and domestic economic volatility. Trade statistics for FY 07 indicate the telecom imports being responsible for 13 percent increase to rising import bill only after petroleum and machinery imports. These volume of current account deficit is approaching fast

Table 7: The Growing Share of Services Deficit in Current Account Balance

Items	97-98	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06
1. Trade Balance	-1,867	-2,085	-1,412	1,269	-294	-444	-1,208	-4,352	-8,259
Exports (f.o.b)	8,434	7,528	8,190	8,933	9,140	10,889	12,396	14,401	16,388
Imports (f.o.b)	-10,301	-9,613	-9,602	-10,202	-9,434	-11,333	-13,604	-18,753	-24,647
2. Services (Net)	**-3,264**	**-2,618**	**-2,794**	**-3,142**	**-2,617**	**-2,128**	**-3,594**	**-5,841**	**-7,304**
Receipts	1,708	1,409	1,501	1,464	2,027	2,967	2,894	3,837	4,718
Payments	-4,972	-4,027	-4,295	-4,606	-4,644	-5,095	-5,488	-9,678	-12,022
Shipment	{921}	{844}	{602}	{877}	{809}	{951}	{1,253}	{1,713}	{2,202}
Investment Income	{2,454}	{1,903}	{2,135}	{2,274}	{2,43}	{2,381}	{2,394}	{2,823}	{3,451}
Others	{1,597}	{1,280}	{1,358}	{1,455}	{1,406}	{1,763}	{2,641}	{5,142}	{6,368}
3. Private unrequited									
Transfers (Net)	3,210	2,274	3,063	3,898	4,249	5,737	6,116	8,440	9,914
(Workers Remittances)	{1,49}	{1,060}	{983}	{1,087}	{2,389}	[4.237}	3.871	4,168	4,600
4. Current Account Balance	-1,921	-2,429	-1,143	-513	1,338	3,165	1,314	-1,753	-5,649

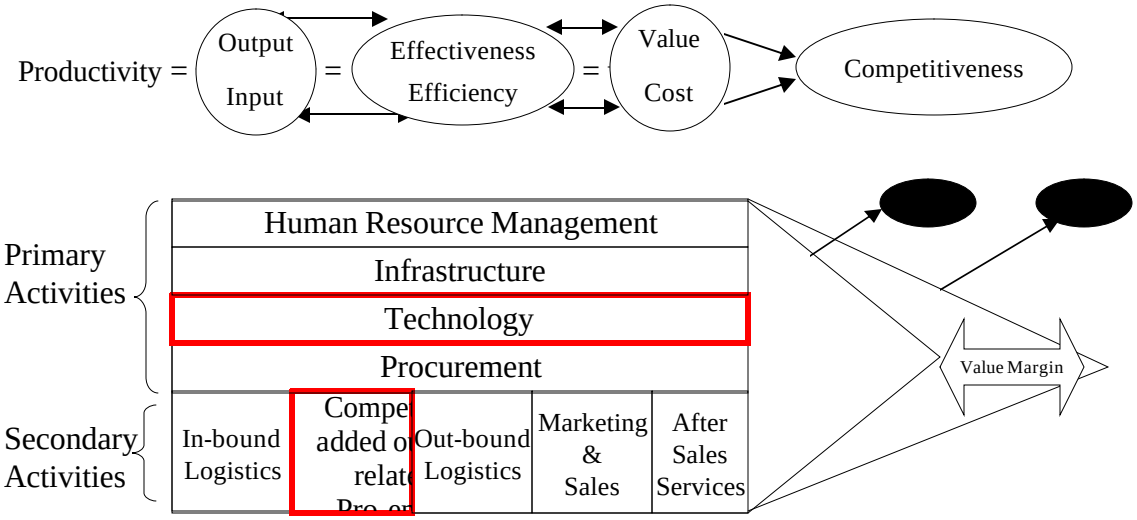
Source: Economic Survey of Pakistan, 2006-07

The SBP quarterly report 2007-08 indicates the dominance of services sector in FDI inflows which remained over 60 percent of the total FDI despite the decline in FDI inflows in the last nine months. The country received FDI to the tune of $2.905 billion (without privatization proceeds) during July-March 2008. The services sector contribution was about $1.743 billion. In this sector, communications (especially telecommunications) and financial services remained the major recipients of FDI inflows. Khan and Kim (1999) has presented a detailed analysis of inflows of FDI into Pakistan and explains the dominance of services sector in FDI inflows. There is a growing debate over this phenomenon and some theorists are of the view that domination of services sector in foreign inflows means less-productive activities and higher outflows through profit repatriation by foreign service providers.

4.3 Services-led Industrial Policy: Implications for Value Addition, Diversification and Competitiveness

In Pakistan, the services sector is not just important in terms of its existing and potential contribution in the national output but it is also strategic due to its potential role in industrial competitiveness, international business activities of domestic firms, poverty alleviation, employment and overcoming current account imbalances in the wake of GATS implementation.

At micro level, the role of services in the industrial firm's productivity and competitiveness is also significant. Porter (1999) suggests that competitiveness of firms should be defined in terms of productivity gains and, thus, defines firms as a set of value activities which are chained together and are the basis of cost and value creation. The model is known as value chain model and was developed in the context of manufacturing firms. Siddiqui (2008) has elaborated the linkage between value margin, productivity and competitiveness of firm. Value margin is the difference between cost of activities and value of output resulting from the business operations of manufacturing firms and is another way to represents the productivity i.e. output/input ratio and is the basis of firm's competitiveness and competitive strategy against its competitors (See Figure 2). A closer look on the value chain model identifies that though the technology and physical capital critically impact the productivity and competitiveness of manufacturing firms, the impact of services oriented activities during the value delivery process is also vital. The services oriented activities either primary or secondary create an enabling environment within the manufacturing firms whereby the physical capital and technology can carry out the transformation process effectively and efficiently.



(Source; Siddiqui, 2008)

Figure 2: Dominance of services in the value chain activities of manufacturing firm

At macro level, also, the strong financial sector, world class transportation and supply chains, dynamic communication services and information technology are the key success

factors for productivity and competitiveness of manufacturing firms. The supply of human capital which includes healthy and skilled workers can also be ensured through dynamic health, education and management consultancy services (See Figure 3). The impact of services inputs on manufacturing firms' productivity and competitiveness is unquestionable as these complementary services inputs create an enabling environment for the manufacturing firms to operate efficiently and effectively in the competitive markets. The services sector, on the other hand, through its intangible output represents the 'software' of the economy to make run the industrial and agriculture sector i.e. 'hardware' of the economy. Findlay (2001) has highlighted the importance of interaction between industrial and services sector policies as part of the services sector reforms for development strategies. The interaction between services and manufacturing is also important due to increased services embedded nature of manufactured goods in their final form to the customers. The automobile industry, for example, is driven by, along with many other factors, the marketing and after sales services to retain the customer relationships and loyalty. Same is the case with computer manufacturing industry where firms are deriving competitive advantage on the basis of downstream services like software support and other customer services.

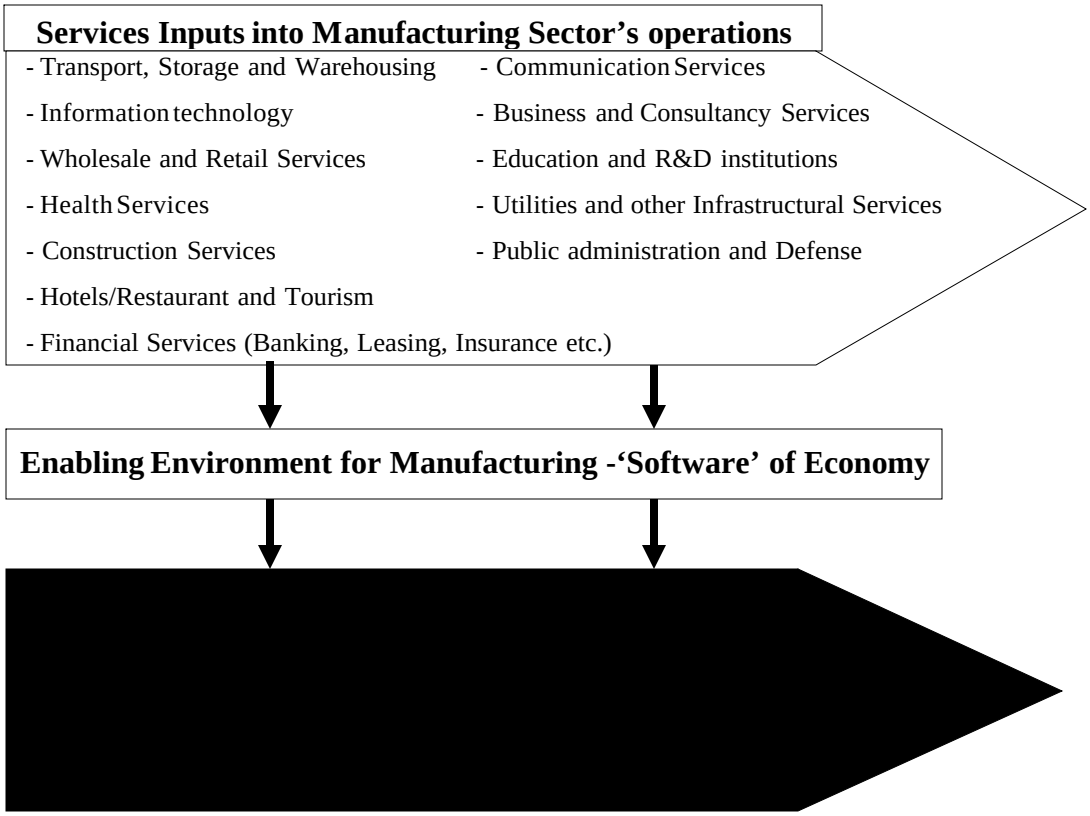


Figure 3: Services sector's inputs into manufacturing sector and its impact on its productivity and competitiveness: A macro level analysis

The role of services sector as the provider of services inputs to the commodity producing sector is not uni-directional in the economic system. The increased use of manufactured

inputs during the effective and efficient delivery of services is as important (See Figure 4). The manufactured inputs to services sector in the economy constitute the necessary 'hardware', which enable services firms' to deliver their intangible output and affect the service quality of services output in many ways. The manufacturing intensity of services is on a rise and many high-end services consume a lot of manufactured inputs during their delivery process. All the services sub-sectors mentioned in figure 3 above require a diverse set of the manufacturing sub-sectors' output as mentioned in Figure 4 below. Though the productivity and competitiveness of services sector depends mostly on the quality and quantity of human capital, the manufactured inputs serve as a necessary conditions or threshold requirement for the services firms' operations. The industrial sub-sectors, thus, should be viewed as an integral part of services firms' value chain networks.

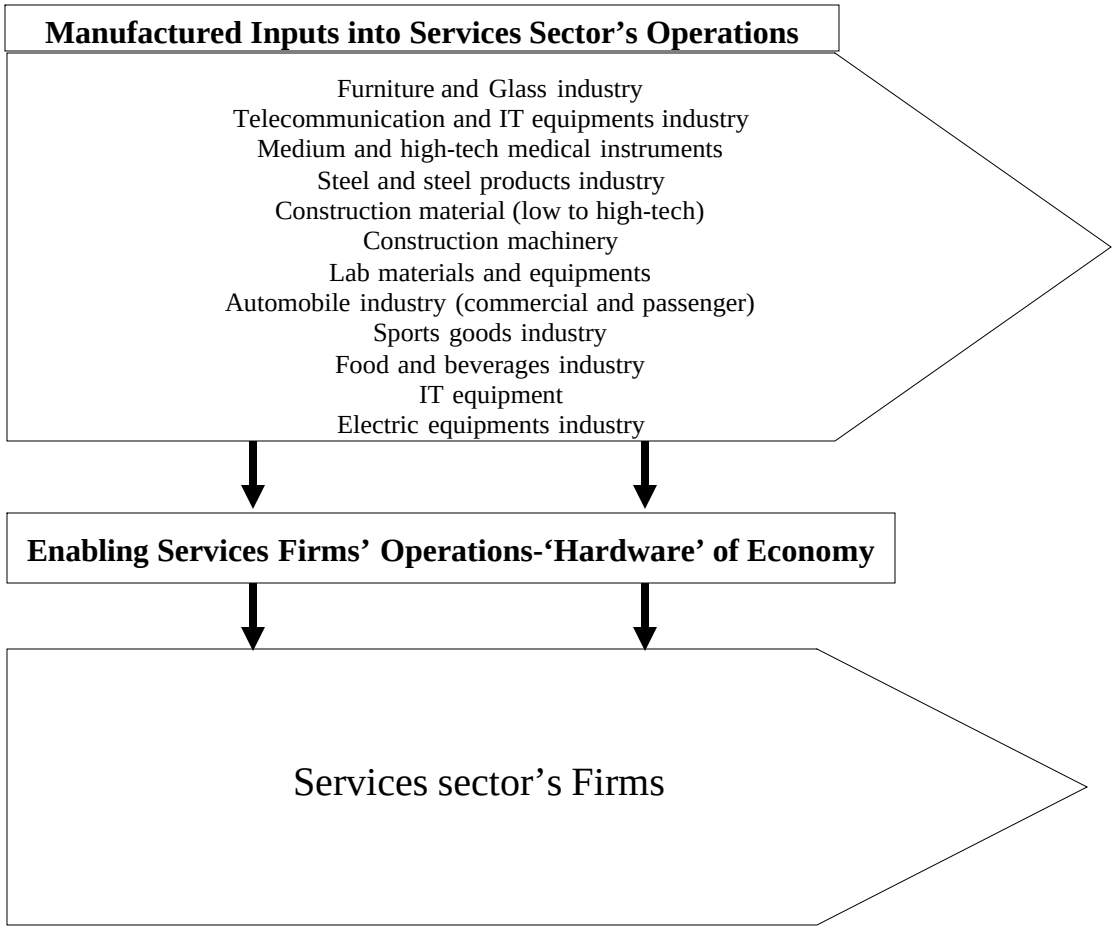


Figure 4: Potential of services-led industrialization in Pakistan for manufacturing value added and diversification: A macro level analysis

This analysis points to the need to develop an industrial policy, which aims at aligning the industrial structure and output with the requirements of the services sector which would in turn facilitate the diversification of industrial output. The diversity of manufactured inputs required by services firms offers potential for manufacturing value

added and diversification in industrial sector. Such industrial diversification will also reduce the dependence of domestic services sector on foreign manufactured inputs and thereby help curbing the trade imbalance resulting from trade liberalization. The development of an incentive structure, under a well elaborated services policy, is also mandatory for the success of services-led industrial policy. Such well worked services policy will attract investment and create a conducive environment for the growth of services sub-sectors, which are complementary to the productivity and competitiveness of industrial sector.

The point to be made is not to develop services sector at the cost of other sectors of the economy rather to align the growth and industrial policies with the structure of services sector in Pakistan. Such alignment will enhance the competitiveness of both sectors by capitalizing over the forward and backward linkages between the two and thereby help these withstand the international competition in a post-WTO regime. The high manufacturing intensity of services in Pakistan as evident from its input purchases from manufacturing sector (MTDF 2005-10, 2004) reveals the policy space required for complementing the industrial policy with the services sector. The value networks of the economy consist of both services and CPS firms and require complete harmony and integration between them to generate and deliver competitive value. A failure to do so would deprive the industrial sector of a very large market to serve with its output.

The lion share of services in Pakistan offers unlimited potential, as mentioned in section I, due to its strong forward and backward linkages with the other sectors of the economy. These inter-sectoral linkages can only be capitalized by integrating economic growth, industrial and trade policies with the services sector. Pakistan already has an industrial sector, which is overwhelmingly dependent on the imported capital equipment as evident from the dominance of machinery and equipment purchases in the import statistics over last 60 years. The dependence of services sector, with around 54% share in national output and 44% in employment, on imported manufactured inputs can spiral up the economic volatility in Pakistan.

The impact of such policy integration is not just limited to employment and economic development but the above discussion implies significant potential gains for economic growth, value addition, diversification and competitiveness (See Figure 5).

While the industry-led growth leads to high growth rates, manufacturing value added and technological spillovers to the rest of economy, such growth, due to its high capital intensity, fails to generate enough jobs and improvement in socio-economic indicators. The services-led growth, on the other hand, results in pro-employment growth, and improvement in socio-economic indicators i.e. poverty alleviation, education, health, R&D, infrastructure etc. due to high labor and skill intensity of services output. A services-dominated growth implies investments in education, skills and health services which in turn have knowledge spillovers for the productivity and productivity of economy as a whole.

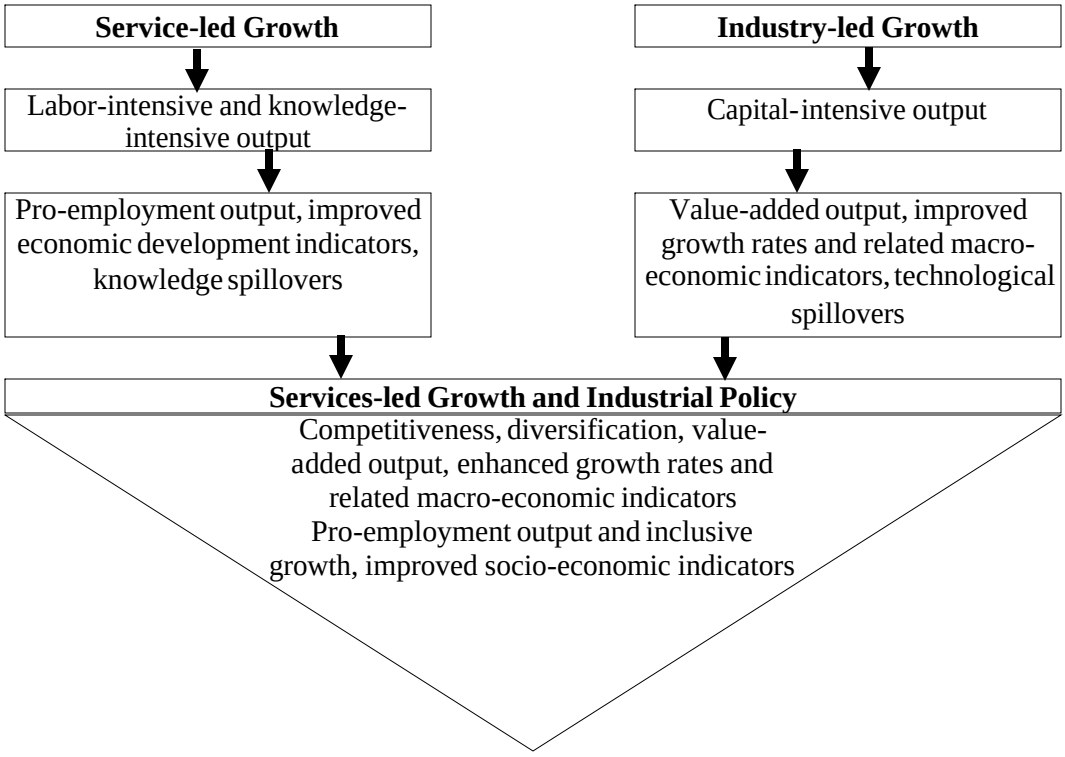


Figure 5: Implications of Services-led Growth and Industrial Policy for employment, value added output, competitiveness, diversification.

The services-led growth and industrial policy can not only achieve both sets of results simultaneously but, due to its synergy effect, also contributes to competitiveness and diversification of commodity producing sector's output. Siddiqui (2008) has mentioned technology, skills and organizational development as the major determinants of the productivity and thereby competitiveness. The impact on competitiveness and productivity of all the sectors of the economy comes, as a result of services-led growth and industrial policy, from the simultaneous technological and knowledge spillovers from manufacturing and services sectors respectively. The competitiveness and diversification of national output enhances the domestic firms' participation in the global markets and thereby contributes to external account balance as well.

Though the discussion here resolves around the complementarities between services and manufacturing sector, yet the results of the policy integration can be fairly generalized to overall commodity producing sectors. In other words, both agriculture and industrial sectors will benefit from such growth and commercial policy that is intervened around the structure of services sector. As already has been discussed, the services and commodity producing sectors should be seen as the 'software' and 'hardware' of the economy respectively and a coherent growth and commercial policy aligning both can enable the economy produce the results of growth, employment, value, added, diversification and competitiveness.

India's successful experience in services especially in information technology and telecommunication has not only supported the overall economic growth and contributed

to services trade surplus but also has contributed to the competitiveness of their industry and its growth rates (Singh, 2005). ----- has identified the complementarities between the output structures of India and China and suggests the possibility of the greatest global economic power if the services-oriented Indian giant is integrated with the manufacturing giant China. At global level, the hypotheses can be confirmed through the empirical evidence from OECD economies, which have specialized in the high end value activities i.e. services and integrated their services sector with the outsourced manufacturing activities in East Asian economies including China

5 Conclusion:

The study has presented the implications of services sector growth and dominant contribution in national output in many Asian economies including Pakistan for their economic growth and industrial policies. The paper analyzes the sectoral composition of output and growth in Pakistan to chalk out the structural transition from an agrarian economy to the services economy. The paper has also analyzed the structural transition in the industrial structure from import substitution industry to an export oriented industry under SAP regime from 1990 to 2007 with its negligible impact on industrial sector's competitiveness, diversification and employment contribution. An alternate model of services-led growth and industrial policy has been advocated for Pakistan with elaborate linkages between services and industrial sectors. The commodity producing sector and services sector are regarded as 'hardware' and 'software' of the economy respectively, complementary for each other's performance. The model suggests enormous potential for pro-employment growth along with competitiveness, diversification and valued added in industrial sector as a result of proposed policy integration. The balanced growth contributed by capital-intensive manufacturing sector and human-capital intensive services sector is expected to boost growth rates and reduce unemployment simultaneously. The limitations of services sector data at disaggregate level are discussed along with directions for future research. The study concludes that the failure to integrate the huge services sector in Pakistan with the commodity producing sectors poses serious threats to sustained economic growth, employment, industrial competitiveness and diversification coupled with external imbalances.

6 Limitations and Future Directions:

The current study identifies the potential for integrating the growth and industrial policies with the services sector of Pakistan. The study is unable to present the measured intensity and significance of inter-sectoral linkages. Moreover, the study has utilized the aggregate data sets about industry and services sector. A study at disaggregated level taking into account the growth rates, gross domestic fixed investment both public and private, and FDI inflows into services sub-sectors, that can explain the growth of services in Pakistan, is able to suggest the precise components of policy interventions under the proposed services-led growth and industrial policy. The study nevertheless presents a well advocated argument for sustainable growth in Pakistan, which can simultaneously help achieve objectives of employment, value added output, diversification and competitiveness of economy.

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